

ANALYSIS OF ORIGINAL BILL

Franchise Tax Board

Author: Bates Analyst: Rachel Coco Bill Number: AB 1604
Related Bills: See Legislative History Telephone: 845-4328 Introduced Date: February 21, 2003
Attorney: Patrick Kusiak Sponsor: _____

SUBJECT: Military Rental Housing Property Tax Credit

SUMMARY

This bill would allow a credit for property taxes paid that are attributable to rental housing occupied by members of the armed forces and their families.

PURPOSE OF THE BILL

The intent of this bill is to provide an incentive to rental property owners to continue to rent, begin to build, or otherwise provide homes to military personnel and their families.

EFFECTIVE/OPERATIVE DATE

This bill is a tax levy and would be effective immediately upon enactment. As specified, it would apply to taxable years beginning on or after January 1, 2004, and before January 1, 2009.

POSITION

Pending.

ANALYSIS

FEDERAL/STATE LAW

Existing state and federal laws provide various tax credits designed to provide tax relief for taxpayers who incur certain expenses (e.g., child adoption) or to influence behavior, including business practices and decisions (e.g., research credits or economic development area hiring credits). These credits generally are designed to provide incentives for taxpayers to perform various actions or activities that they may not otherwise undertake.

Current state and federal laws generally allow taxpayers engaged in a trade or business to deduct all expenses that are considered ordinary and necessary in conducting that trade or business, including property taxes paid for rental property.

Under federal and state laws, compensation received by a member of the armed forces is subject to income tax unless specifically excluded. There are also certain benefits and allowances that are excludable from gross income. One of these items is the Basic Allowance for Housing (BAH). The BAH provides equitable housing compensation for those members who live in non-government housing outside the military base.

Board Position:

<input type="checkbox"/> S	<input type="checkbox"/> NA	<input type="checkbox"/> NP
<input type="checkbox"/> SA	<input type="checkbox"/> O	<input type="checkbox"/> NAR
<input type="checkbox"/> N	<input type="checkbox"/> OUA	<input checked="" type="checkbox"/> PENDING

Department Director
Gerald H. Goldberg

Date
03/28/03

THIS BILL

This bill would allow a 100% credit for property taxes paid or incurred during the taxable year by a taxpayer that are attributable to rental housing that is occupied by a member of the armed forces and their family.

Any credit that exceeds the taxpayer's tax liability could be carried over indefinitely.

This credit would be repealed as of January 1, 2010.

IMPLEMENTATION CONSIDERATIONS

This bill uses terms that are undefined, i.e., "attributable," "accommodate," and "rental housing." Without clear definitions, this bill could lead to disputes between taxpayers and the department.

It is unclear if the members of the armed forces need to be on active duty or whether members in the reserves would qualify. It also would give clarity if the bill defined "their families" to mean members of the armed forces and their immediate family, i.e., spouse and dependent children, or relatives that reside in their household. The absence of definitions to clarify these terms could lead to disputes with taxpayers and would complicate the administration of this credit.

The bill uses the term "members of the armed forces." In order to provide consistency with existing law, the bill should be amended to instead refer to the federal and state term "members of the Armed Forces of the United States."

This bill does not specify how long a taxpayer has to accommodate a member of the armed forces and their family in order to qualify for the credit. A taxpayer could rent the home for one month, then occupy the property for personal use for the duration of the taxable year and still qualify for the credit. This would also apply to a taxpayer who rents a room within a home or rents the guest home located on their primary residence to a member of the armed forces. If this is not the author's intent, further clarification is needed.

Also, the bill does not provide rules for the situation where an owner of an apartment complex rents to both military and non-military tenants. The author may wish to amend the bill to specify that the property tax would be prorated based on the share of the total rent payments from members of the military.

This bill allows an indefinite carryover period. As a result, the department would be required to retain the carryover on the tax forms indefinitely. Recent credits have been enacted with a carryover period limitation since experience shows credits typically are exhausted within eight years of being earned.

LEGISLATIVE HISTORY

AB 2487 (Bates, 2001/2002) contained the same language as this bill, but failed to pass out of the Assembly Appropriations Committee.

SB 1631 (Morrow, 2001/2002) was identical to this bill, but was amended to delete the provisions that would have allowed the credit. SB 1631 failed to pass out of the Assembly Appropriations Committee.

OTHER STATES' INFORMATION

The states surveyed include *Florida, Illinois, Massachusetts, Michigan, Minnesota, and New York*. These states were selected due to their similarities to California's economy, business entity types, and tax laws.

Illinois, Massachusetts, Michigan, Minnesota, and New York laws do not provide a credit comparable to the credit allowed by this bill.

Florida does not have personal income tax; therefore this credit is not applicable.

FISCAL IMPACT

Once the implementation concerns are resolved, this bill would not significantly impact the department's costs.

ECONOMIC IMPACT

Revenue Estimate

This bill would result in the following revenue losses:

Revenue Impact*			
Tax Years Beginning On Or After January 1, 2003			
Enactment Assumed After June 30, 2003			
(\$ Millions)			
Fiscal Year	2003-04	2004-05	2005-06
	-10	-225	-185

*Rounded to the nearest \$5 million.

This analysis does not consider the possible changes in employment, personal income, or gross state product that could result from this measure.

Revenue Discussion

The revenue analysis is based on available data and makes the following assumptions: 1) the term accommodate means units occupied by qualified military personnel in California; 2) the credit to the property owner would be pro-rated based on that share of the total rent payments received by qualified members of the armed forces; and 3) the members of the armed forces being accommodated are active duty military, not part-time reservists or National Guard.

Data provided by the Office of the Deputy Undersecretary of Defense (Installations and Environment) identifies 81,634 active duty military members currently renting non-government housing in California. Property tax projections were derived from median home values as reported by the California Association of Realtors. The revenue estimates allowed for an allocation of property taxes to owners in cases of multiple family rental property having both qualified military and non-military renters.

Of total military personnel, 60% are married. It was assumed that married personnel were in single-family detached houses with the full property tax value. Property taxes paid were estimated by multiplying the 1.0% tax rate by the median home price in 2002 and by the number of married personnel (\$315,900 property value x 1.0% property tax rate x 48,980 married personnel = \$155 million).

It was also assumed that single personnel were in multiple-family housing with an average of five units, so that the property owner may use one-fifth of the total property value. (\$32,700 single personnel x by 1/5 of the property value (20% x \$315,900) x the 1.0% property tax rate = \$21 million).

The two impacts were added and grown out for subsequent years by a 2% growth rate based on home assessment values.

The amount of credits used in fiscal year 2003-04 is low compared to subsequent fiscal years because it includes only the first half of the tax year in which the credit goes into effect. Also taken into account is the delay in allocation of the qualified portion of property tax attributed to military tenants. The sharp increase in 2004-05 reflects the first full tax year in which the property tax may be claimed, plus a portion of the 2005 property tax.

ARGUMENTS/POLICY CONCERNS

Generally, credits are provided as a percentage of amounts paid or incurred. This bill would allow a 100% credit, which is unprecedented. In addition, if a 100% credit is intended, it may be more efficient to instead allow a property tax offset instead of an income tax credit.

This bill would allow a rental housing owner to claim an income tax credit for the real property tax, which is already deductible from the income tax. Thus multiple tax benefits would be provided for the same item of expense.

This credit would not be limited to property in California. A taxpayer that pays property tax and rents that property to a member of the armed forces anywhere in the world and owes California tax could claim the credit. The author may wish to amend the bill to specify that this credit would only apply to rental housing located in California.

LEGISLATIVE STAFF CONTACT

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